DOW THEORY LETTERS INC.

RICHARD RUSSELL
P. O. BOX 15196
SAN DIEGO, CALIFORNIA 92115

Registered with the Securities Exchange Commission

40 Letters per Year — $50.00 Annually

March 23, 1965 Letter 283

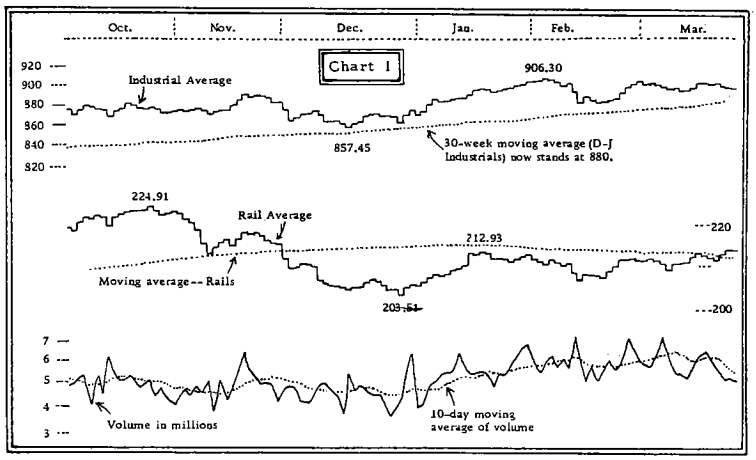
THE MARKET: The history of the stock market (although few are aware of it) is a history of bull and bear markets as defined and interpreted under Dow's classic Theory. According to Dow Theory the peak of a bull market is reached on the day when the two Averages (Industrials and Rails) record their highest joint peaks (often referred to as the last confirmed highs). The last confirmed highs of this bull market were recorded on October 20, 1964. Although Industrials have pushed higher since then, the Rail Average has not yet bettered its October high of 224.91. The lowest points reached on the decline from the October highs were the 857.45 and 203.51 levels of December, 1964 (study Chart 1). During 1965 Industrials rallied to a new all-time high of 906.30 (February 3), but Rails have persistently refusec to confirm.

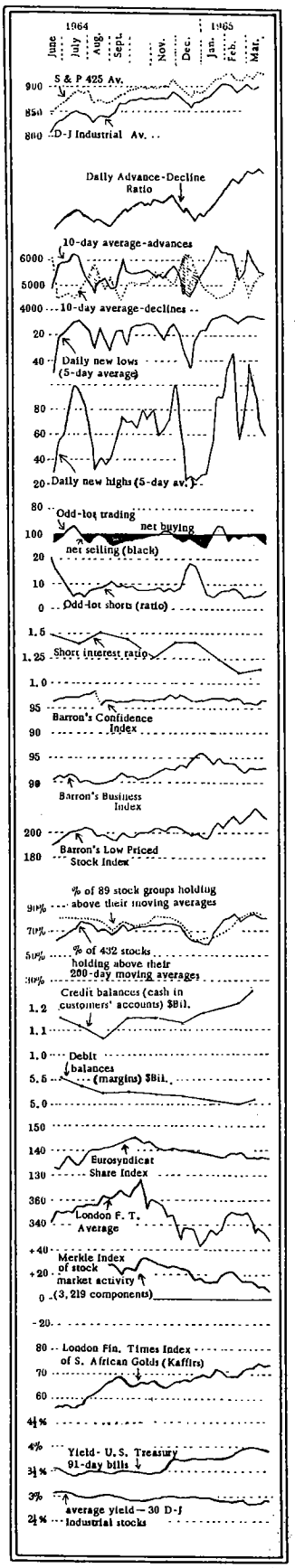
Thus, the two Averages have been fluctuating for five months between the primary highs (224.91 and 906.30) and the secondary lows (857.45 and 203.51). What is the meaning of this long, frustrating sideways movement? What we are seeing is the Averages "weighing" the economic climate ahead; probing, testing, hesitating, trying to decide whether the path is clear or whether dark clouds are massing on the horizon. The area between the last highs and the last lows is known as "secondary territory," and it always represents a difficult area for investors. On June 2, 1934, during a similar situation, the great Dow Theorist Robert Rhea wrote: "I have frequently implied that neither I nor any other man can possibly know, with certainty, the primary direction of the market when the Averages are backing and filling in an area between a primary high point and a secondary low point. We are in such an area now, and have been there since last October. Joint penetration of last July's high points will indicate a resumption of the bull market, and if, prior to that event, the October low points are broken downside, then it will be in order to call the movement since July, 1933, a bear market."

Substituting the current situation for the 1934 situation I can rephrase Rhea's words as follows: "We are in such an area (i.e., a secondary area) now, and have been there since last October. Joint penetration of last October's Rail high (224.91) and February's Industrial high (906.30) will indicate a resumption of the bull market and if, prior to that event, the December lows are broken downside, then it will be in order to call the movement since October, 1964, a bear market."

So here we are, in a market which is working sideways in secondary territory, and there is not a man on Wall Street or any other street who can guarantee the direction of the primary trend — until the market itself gives us "the final word." From the standpoint of orthodox Dow Theory, however, bulls can lean on the axiom which states that a trend is taken to remain in force until proved otherwise. The trend was last reconfirmed as bullish, and as long as one or both Averages hold above the December lows we will accept it as bullish.

On March 12 Rails bettered their January (secondary) high of 212.93, but surprisingly Industrials (which up to then had been the stronger Average) refused to confirm. Thus during February we saw an Industrial rise to an all-time high unconfirmed by Rails, and in March we witnessed a Rail rally above a secondary peak (above 212.93) unconfirmed by Industrials. In the writer's opinion the series of non-confirmations and the general "confusion" being displayed by the





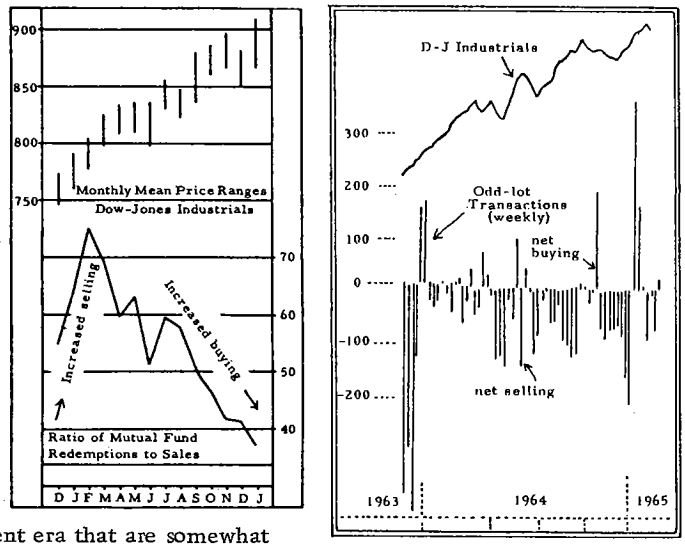
 Averages is indicative of the confusion which the market itself feels towards the economic and political future. When the Averages disagree, it pays to be careful.

Another paragraph from Rhea's service strikes me as particularly interesting at this time. This was written on October 3, 1933: "Some months prior to the final primary swing in a bull market, it is usual for a well-defined area of distribution to develop (see January to May, 1929). Strictly speaking, these periods must be classed as accumulation, because prices finally work out topside. Nevertheless, it is while this see-saw motion is occurring that some men unlock their boxes and sell their securities to margin traders. Brokers' loans and call money generally advance rapidly while the suckers try to swallow the bait, hook, line and sinker."

The above paragraph by Rhea was inserted for a definite purpose. Referring to the Composite Chart (Page 1), we note that over the past months there has been an actual increase in the market's technical strength. This brings to mind the old adage: "The market always does what it's supposed to do — but never when it's supposed to do it." Many observers (the writer is one of them) suspect major trouble ahead for the market and the economy. But in the face of increasing technical strength, I ask myself: is it possible that the market is poised today (as it was in early 1929 or late 1936) for a final "blow-off," a last speculative fling which would serve to confound even the bulls? I feel that we cannot rule out such a rise. What would signal it? The answer is a push by both Averages above their all-time highs accompanied by surging volume and excited buying in the speculative (low-priced) segment of the market.

Increased strength is being displayed by (1) odd-lot transactions which are now in their heaviest selling area since January; (2) a rise in the total short position (up 295 thousand to 6.7 million) which pushed the short ratio to 1.14; (3) customer's credit (cash) balances which rose $47 million in February and is tending to confirm the odd-lot studies; (4) debit balances which rose $19 million in February (although it should be remembered that the long-term trend of the debit or margin accounts is down and therefore bearish).

The Merkle Index dropped to its lowest point of the year at approximately 7, but this Index is still above the critical zero level. The S. African gold (Kaffirs) Index holds within a point of its 1964-65 high. The action of the gold index is in sharp contrast to many other indices. Last week, for instance, the French, Dutch, Swiss and West German stock averages broke to new 1965 lows (more on this later in this Letter).



WHITHER THE PUBLIC? One of the greatest mysteries of the past year has been the attitude and psychology of the public. The two accompanying charts underscore this mystery. The first chart shows the odd-lot figures since December, 1963, expressed as weekly plus or minus totals. If more odd-lot shares were bought than sold for the week, the bar projects above zero, and the converse if more odd-lot shares were sold than bought during that week. A quick glance at the chart will serve to show that during the major part of the period since late 1963, the odd-lotters were net sellers of stocks. Normally, this is a bullish technical omen for the market. It suggests that while the odd-lotter was selling the advance, some other force (presumably the big buyer) was absorbing all the shares offered and pushing the market higher.

So tenacious has this odd-lot selling been that Mr. Garfield Drew (the outstanding odd-lot expert) recently remarked: "The odd-lot public seems to have developed some built-in tendencies in the present era that are somewhat at variance with long-term normal characteristics. One is the background fact that when there are only gentle changes in the price level, transactions are slightly on the selling side, whereas on the basis of long-term record, there should ordinarily be a definite predilection for buying."

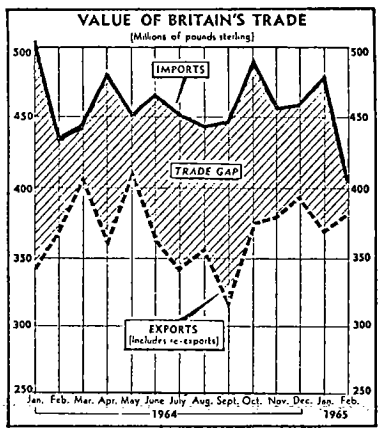
Against this background of steady odd-lot selling, we have the remarkable picture of mutual fund transactions. Presumably, the mutual fund buyer represents the public or the "little fellow" in the same way that the odd-lot trader represents the public. But if we examine the ratio of mutual fund purchases to sales, we see an indicator which shows a swing from extreme doubt and bearishness in early 1964 to great complacency and out-and-out bullishness in 1965.

The chart above traces the ratio of monthly mutual fund purchases to redemptions from December, 1963 to the present (the same period covered by the odd-lot chart). From the bearishness of January, 1964, of about 75 on the ratio (i.e., 7.5 shares sold for every 10 purchased), the ratio has shifted to its latest (January, 1965) reading of only 37 (3.7 shares sold for every 10 purchased). Thus the mutual fund buyer is becoming increasingly bullish in that he is stepping up his buying sharply while curtailing his selling (total purchases in January, 1965, touched a record $400 million). The last example of this type of increasing bullishness occurred during the last three quarters of 1961 when the mutual fund ratio dropped from 50 to 30 (actually a much smaller change than we have witnessed over the past year).

What are we to think? Is the public now in the market (via mutual funds) to the point where the whole picture has turned dangerous, or are the odd-lot statistics correct in implying that the public is still skeptical? My own feeling (as stated before) is that the

public is heavily in the market via the funds, which implies that the public is bullish about the future of the market. Nevertheless, the public has still not completely recovered from its fright during the 1962 crash when so many of its "hand-picked" stocks collapsed. Therefore, I believe the two sets of statistics shown on the charts imply a public which is bullish on the market but bearish on its ability to pick "the right issues."

INTERNATIONAL SCENE: As the great post-War boom grows older, it is becoming increasingly obvious that the economies of the many nations of the Free World are linked together like a chain. For this reason, I have insisted that my subscribers become thoroughly familiar with world fiscal and monetary events. The accompanying chart (from the N. Y. Times) shows the February improvement in the British balance-of-payments. However, a good part of this improvement was due to the sharp drop in imports. A major factor behind the import drop was the American dock strike, and this is a factor which will not be present in the period ahead.



* * *

Without attempting to play the part of a soothsayer, I suggest that subscribers turn back to Letter 273. In that Letter I wrote: "The place where the new money rates are liable to produce the next serious trouble is Japan. The Japanese boom has been running at white heat, and it has been able to do this by turning over its limited supply of dollar reserves at a tremendous rate. Lately, however, Japan has been running out of its dollar 'ammunition.' Its stock market has been subject to heavy liquidation, and in desperation the Japan Joint Security Co. (made up of leading bankers and brokers) has been formed for the purpose of supporting the Japanese market (stocks are purchased whenever the Japanese 'Dow' drops under 1200) ..... In this writer's opinion the chain of rising interest rates will probably touch Japan next."

On March 6, 1965, a dramatic event rocked Japan. The Sanyo Specialty Steel Co., Japan's largest specialized steel company, filed for bankruptcy. This represented a whopping $100 to 150 million bankruptcy and is comparable to a $1 billion bankruptcy in the U. S. Even more shocking to investors was the fact that the great Fuji Iron & Steel Co. (owner of 4% of Sanyo's stock) failed to come to Sanyo's rescue, and this prompted speculation about Fuji's financial shape. Last week (according to the London Economist (March 13) ".... six of the nation's major iron and steel manufacturers met in Tokyo to discuss the shelving of plant investment plans for a period of six months while they decide how to adjust investment projects for the future ..... Although the lesson has been a spectacular one, it is not yet over. More than 100 medium and small special steel companies are expected to collapse within the next few months ....."

Last week, in response to the series of economic upsets, the Japanese market average (see chart in Letter 281) plunged under the 1200 level to a four year low. This violent break led observers to conclude that the Joint Security Co. had suspended operations (at least temporarily).

It is gradually dawning on our fiscal manipulators both in Washington and elsewhere that when the balloon is inflated too far, a leak is sure to appear. But when a patch is applied to the leak, another leak is likely to spring up somewhere else. As the program to save the dollar is applied, Europe is beginning to feel the pinch. Under the Johnson series of voluntary measures, the supply of dollars in Europe is suddenly tightening. U. S. banks have now pulled way back on their loans to Europe with the result that American firms in Europe are actually adding to the money squeeze. This is occurring because these American firms are now borrowing in local European markets and because these same firms are sending their spare dollars back to the U. S. A further result is a sudden weakening of many European currencies.

The next act in the gathering international drama could well be a toppling of the European boom (and it should be remembered that the more success the U. S. has with its balance-of-payments, the greater the danger to the European boom). Already reports are arriving of economic troubles in France, Japan, Italy, Belgium and Switzerland. One thing of which we can be sure: if recession should envelope Europe, every European nation will focus its eyes on "the big market." The big market is the U. S., and it is here that Europeans will turn to first in an effort to "dump" surplusses of goods of all types. (I suggest that all subscribers read the Wall Street Journal's March 18 front page article entitled "Slowdown in Europe").

STOCKS: I have been deluged by letters from subscribers asking where information can be obtained on the Kaffirs. One source is your broker. Brokers can easily obtain quotes on all ADR's; they can also obtain all needed statistics. Merrill, Lynch put out an excellent report on the Kaffirs on January 1, 1965. Standard & Poor's Foreign Securities Survey provides reviews of the Kaffirs. I have recommended Western Deep Levels many times. This stock is composed of 5.6 million "A" shares and 19.4 "B" shares. As soon as the A shares pay a full $1.40, all further dividends will be shared equally. The A shares are the only dividend payers now, and they have paid out about 80¢ so far. In other words, as soon as the A's pay another 60¢, the dividend payout will be the same on the full 25 million shares of common. The following comment about Western Deep is from Alden Well's latest Monetary Report (Palisades Pk., N. J.): "Budgeted work could produce earnings of $2.00 in 1966 and a net dividend of $1.50. This huge enterprise is a suitable investment for institutions as well as individuals. Its present market value, which could double without any increase in the price of gold, already exceeds that of Dome, Campbell Red Lake, and Homestake combined." Western Deep A shares (with a dividend estimated at around 50¢) represents solid value. If earnings next year are anywhere near $2.00 and the stock sells at a mere 9 times earnings it could sell for 50% above the current 12 level (with no British devaluation). Finally, on the subject of S. African golds in general, I found the accompanying article in the March 15 New York Times so fascinating that I

Gold Miners Find South Africa Gets Most for the Metal

By EDWIN L. DALE JR.
Special to The New York Times

WASHINGTON, March 14—Has the price of gold, as so often argued by those who believe there must be a gold price increase, stayed the same for 30 years while the price of nearly everything else has more than doubled?

On its face, the answer seems to be, yes. The official gold price is $35 an ounce today, the same as 30 years ago.

But experts here are saying that the answer is an emphatic no for the most important group of individuals concerned: Those who mine the bulk of the world's gold.

In terms of their own money, South Africans receive 74 per cent more for gold today than they did 30 years ago. Its price has gone up almost as much as the price of other commodities. No doubt that is one reason for the present record rates of production of the yellow metal.

An Increase of 74 Per Cent

In 1935, an ounce of gold in South Africa brought 7.18 South African pounds. In a purely internal change, pounds were changed into rand in 1961, at the rate of two rand for one pound. Today an ounce of gold brings 25 rand, or 12.5 of the former pounds. A rand is equal to about $1.40 (United States).

In terms of his own money, therefore, a South African has seen the price of gold rise by 74 per cent—from £7.18 to £12.5. The biggest jump was in 1949, when gold rose £8.68 to £12.5.

The reason, often forgotten, is that until very recently the South African pound was tied directly to the British pound, and thus worth about $2.80. When the British pound was devalued in terms of the dollar and of gold, the South African pound went with it. Given a fixed dollar price of gold, each devaluation amounted to a windfall for gold producers, not only in South Africa, but in other countries of the sterling area that produce gold, such as Australia and Ghana.

The British pound has dropped from $4.86 in 1935 to about $2.80 today.

The windfall was denied, of course, to United States gold miners. They get the same $35 an ounce, while their costs have risen along with prices generally over the 30-year period. This is one good reason why United States production has declined while South African output has soared.

wish to bring it to the attention of all "magnifying glass-carrying" subscribers.

In the last Letter I wrote that I was "very hesitant about recommending new stocks here." I am even more reticent today. I call subscribers attention to the Merkle Index on Page 1. My friend Dan Merkle, President of Traders Research, compiles this private Index each week. Merkle is a superb market student. He is in the unusual position of being "immersed" daily in thousands of stock charts. The readings of this Index are somewhat unique in that they are weighted heavily by actual stock and group action. You can fool a lot of people and you can fool a lot of indicators, but you cannot fool thousands of charts which show what individual stocks are actually doing.

As I studied the profiles of hundreds of daily charts in the Traders Research chart book this morning, I was somewhat taken back by the amount of lethargy and "sloppiness" which has crept into this market. A great many stocks seem to have lost their upwards momentum, others are now slipping off, still others are "hanging" on low volume. This may be a mere hesitation preparatory to another upward push or it may be the reflection of what the "Momentum Index" (see Letter 282) has been saying — that the upward push is exhausting itself. At any rate, the Merkle Index at a 1963-65 low of 7 is accurately showing us what the market (broken down into its components) is doing. It is not an impressive picture, as far as I am concerned.

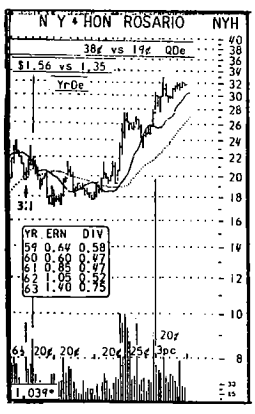
SAN DIEGO: As a New Yorker who took the trek West, I am always interested in the East-West controversy. In the current issue of Esquire, an article, "The Affluent Poor" is sub-titled "In Southern California, the very poor are different than you and me — they live better." Most of the article is about the San Diego (Mission Beach area), which (and I'll testify to this) is one of the most extraordinary areas in the nation. Here you can spend the year-round on a surfboard, you can sit and contemplate the latest styles in female bathing suits, you can fish, sunbathe, read the latest avant-gard literature or simply relax and study the geometry of the waves. Within an hour's travel time in various directions you can choose the mountains, the desert, Mexico, La Jolla (Southampton of the West Coast), the seclusion of Mt. Palomar, the bustle of San Diego (one of the cleanest cities in the nation), the majesty of the deserted highways leading to the southeast and inland Mexico or the waters off Baja (Mexico), reputed to be the finest fishing area in the world. On top of this, prices in San Diego are low, rents are reasonable, help is abundant and the cost of labor is low (one reason: the unemployment rate in San Diego has dipped below 7% only twice in three years).

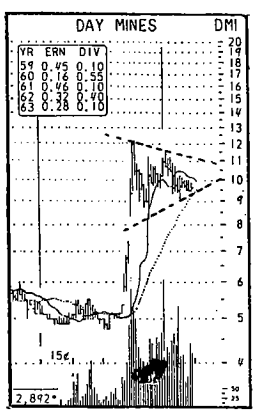
The writer is not posing as a member of the Chamber of Commerce, but if any subscribers are searching for a place to vacation or retire (or to work), I can recommend San Diego. As the saying goes, rich or poor its nice to have money, but I'll go along with the Esquire article. San Diego offers more of what counts (as far as I'm concerned) for less than any other place I've seen in these United States. (This may answer the many subscribers who have been asking me why in the devil I left New York City after having spent most of my life there).

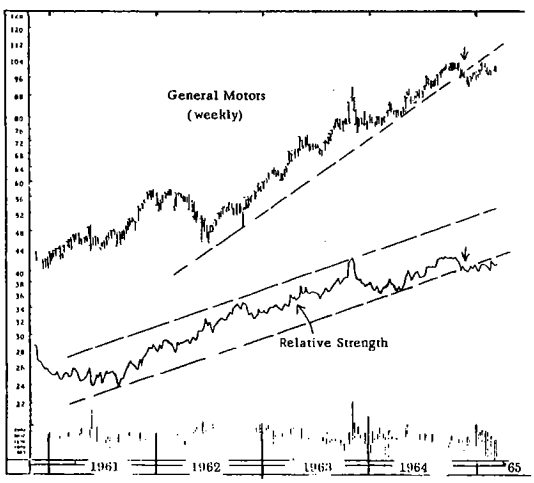
How does the above fit in with the "possible blow-off" thesis as discussed on Page 2? Remember, the final surge theory is just that — a theory — while the above comments on the Merkle Index and the market are concerned with what is actually happening and showing itself on the charts now. This is a tricky market; it is being scrutinized by thousands of analysts all over the nation. If the Averages go to new highs, then the blow-off can be expected. But the Merkle Index and the profile of hundreds of daily charts suggest to me that new highs for the Averages may not be ahead.

I again stress the importance of the Motor Group to this market (see last Letter). A subscriber who happens to be an investment manager concurs with this and writes: "The cyclical nature of the auto business is a major factor in the fluctuations of our FRB Production Index. Note that in Europe with a much smaller auto industry there have been only minor jiggles in their production curves in the post-war period." He adds: "It's the biggest business in the most volatile segment of our consumer durables." As autos go, so goes the boom from here. Today General Motors, best acting of the auto stocks, rose above its all-time high of 102 5/8, but the stock closed below that level. On the other hand, Chrysler is now back to its price level of last September. The third of the "Big Three," Ford remains in a long, sideways trading range, but its relative strength line is currently at its lowest level since 1961. Thus only GM of all the auto companies is "acting well," and even GM bears watching. The weekly chart shows GM violating its long-term trendline while its relative strength line has emerged from the bottom of its channel. This is the stock to watch. As long as it holds above 96, GM can be considered bullish.

The silver issues are of interest here as Wall Street awaits the report from the U. S. Treasury regarding silver. Since most government decisions are compromises (as per the recent removal of part of the 25% gold clause), my bet is that the silver content of our coins will be lowered rather than removed. If so, then we can probably expect a further rise in the price of silver metal. The silver stocks will probably reflect this, and already Sunshine Mining is pushing against its "roof." Day Mines and N. Y. Honduras and Rosario represent a "package" which I believe will move out if the Treasury brings out a report favorable to the silver interests. Watch for a hint of good news for silver holders: such a hint (via the market) would be a push by Day Mi nes out of the triangle (see chart) and then above the 12 area — with expanding volume.







Silver charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas. GM chart courtesy Traders Research, 1431 Pearl St., Alton, Ill.